

**Letter of Findings: 04-20170564R; 04-20170565**  
**Gross Retail Tax**  
**For the Years 2011, 2012, 2013, and 2014**

**NOTICE:** IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Final Determination.

### HOLDING

The Department agreed with an Indiana company that conducts research in the healthcare industry that much of its computer hardware was exempt from sales and use tax because the hardware was directly used in performing qualifying research and development; the Department did not agree that all of its computer software programs were also exempt because much of the software performed administrative and support functions which were incidental to the research and development activities.

### ISSUES

#### **I. Gross Retail Tax - Research and Development Property.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-1; IC § 6-2.5-3-2; IC § 6-2.5-5-40 (effective January 1, 2016); IC § 6-2.5-5-40; IC § 6-8.1-5-1; *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Conklin v. Town of Cambridge City*, 58 Ind. 130 (1877); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399 (Ind. Tax Ct. 1991); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); [45 IAC 2.2-4-1](#); Sales Tax Information Bulletin 75 (April 2017); Sales Tax Information Bulletin 75 (July 1, 2013); Sales Tax Information Bulletin 75 (October 2008); Blade Server, [https://en.wikipedia.org/wiki/Blade\\_server](https://en.wikipedia.org/wiki/Blade_server).

Taxpayer argues it was not required to pay sales or use tax on the purchase of certain equipment because the equipment qualifies for the research and development sales tax exemption.

#### **II. Administration - Ten Percent Negligence Penalty.**

**Authority:** IC § 6-8.1-5-1; IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer asks that the Department exercise its authority to abate the ten-percent negligence penalty.

### STATEMENT OF FACTS

Taxpayer is an Indiana company in the business of researching and developing medical products.

Taxpayer filed a 2011 refund claim seeking the return of sales tax paid on the purchase of equipment, computer software, and "hardware." Taxpayer claimed a total refund of approximately \$80,000.

The Indiana Department of Revenue ("Department") reviewed Taxpayer's refund claim. The Department denied approximately \$38,000 of the 2011 claim.

The Department conducted an audit review of Taxpayer's 2012, 2013, and 2014 purchases. The audit resulted in an assessment of additional sales/use tax. The assessment "offset" a portion of the 2011 \$42,000 tax refund.

Taxpayer disagreed with the Department's decision denying a portion of the original 2011 refund and on the assessment of additional 2012, 2013, and 2014 sales/use tax. Taxpayer submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representative explained the basis for the protest. This Final Determination - addressing *both* the disputed 2011 refund and the subsequent 2012 through 2014 assessment - results.

## **I. Gross Retail Tax - Research and Development Property.**

### **ISSUE**

Taxpayer claims that it was not required to pay sales tax or self-assess use tax on the purchase of equipment, computer software, and "hardware" because these items were used in the research and development of its medical devices. As a result, Taxpayer asserts that these items are exempt under Indiana law.

#### **A. The Department's Review of Taxpayer's Refund Request.**

Taxpayer filed a GA-110L Form, claiming a refund for sales and use tax paid during 2011. The Department reviewed Taxpayer's 2011 refund claim and simultaneously conducted a 2012 through 2014 audit.

In both instances, the Department's audit noted that Taxpayer's medical development process progressed through the same steps. As explained in both the audit and refund reports:

First is the conception of an idea through thorough analysis of the product in their . . . lab. Second, they go through what is called a bench test, where the product goes through various mechanical, corrosion and fatigue testing. The [third] phase of the development stage the product goes through . . . testing, and finally [fourth] to clinical trials.

The review of Taxpayer's refund request was conducted employing a "statistical sampling" methodology more fully described below in Part B.

Necessarily, the audit relied on that version of IC § 6-2.5-5-40 in effect prior to July 1, 2013. The refund report explains as follows:

This law states that lab equipment computers, computer software, telecommunications equipment, and testing equipment that has not been previously used in Indiana and is acquired by the purchaser and devoted directly to experimental or laboratory research and development for new products, new uses of existing products, or improving or testing existing products are exempt from sales and use tax. However, it does not include efficiency surveys, management studies, consumer surveys, advertising promotions, testing for the purpose of quality control or research in connection with literary, historical or similar projects. *Hence, consumables including prototypes, hand powered tools, or property with a useful life of less than one year are considered taxable. (Emphasis added).*

The Department's review granted the requested refund in part. "Taxpayer was given credit for lab equipment and software directly used in research and development." The Department denied the refund in part. "Taxpayer was denied credit for consumables such as lab supplies, chemicals, vials, beaker[s], tools and accessories, security software, tubing and equipment not part of direct research." Taxpayer was also denied credit for "miscellaneous items" "incidental to the research and development process." For example, the Department denied the refund on the purchases of:

- Lab Supplies;
- Accessories;
- Cables;
- Sneeze Guard;
- Security Software;
- Silicone Tubing;
- Vials;
- Blade Server Storage;
- Computer Accessories;
- Test Tubes;
- Chemicals; and
- Disposable Filters.

The Department granted in part the refund sought for purchases of "capital assets" with certain exceptions. The Department denied a refund on the purchase of:

- Printer;
- Cloud Based Operating System; and
- P2P Fiber.

The Department denied the refund on the purchase of "software used mainly in the . . . storage, collection and management of research data" because this software was "incidental to the research and development process" and was employed "mainly for the efficient management and operation of the company."

#### **B. The Department's Audit Assessment Results.**

As noted above, along with reviewing Taxpayer's 2011 GA-110L refund request, the Department conducted an audit review of Taxpayer's 2012 through 2014 purchase records. That audit review resulted in an assessment of additional tax.

The Department determined that "due to the amount of records involved," that it would be appropriate to utilize a "statistical sampling methodology" in reviewing Taxpayer's purchase records. Taxpayer provided the requested documents, a "pull list" of sample transactions was prepared, and the "pull list" was provided to Taxpayer's representative.

After discussing the pull list with Taxpayer, a revised list was prepared and an "error percentage" was generated to "arrive at [] total additional tax purchases . . . ." The Department arrived at an error rate of approximately ten percent.

The Department agreed with Taxpayer that "most" of its purchased items "were used directly in [] research and development." However, the Department also concluded that other purchases "were used or consumed in the normal operation of [Taxpayer's business and [were] incidental to the research development process."

The Department's audit report included a listing of items for which Taxpayer owed additional tax. For example - and in small part - the audit determined that Taxpayer owed tax on the purchase of:

- Phone case;
- Battery;
- Lab Supplies;
- Reference Books;
- Scissor Jack;
- Binders;
- Tools;
- Maintenance Supplies; and
- White Boards.

The Department's audit noted that Taxpayer purchased computers during the audit period and agreed that, because most of Taxpayer's activities involved research activities, that the computers were "used 90[percent] of [the] time for research . . ." and were "taxable 10 percent of the time."

The Department also reviewed Taxpayer's purchases of "capital assets" and agreed that certain assets were exempt from tax because the assets "were directly used in research." For example, the Department determined that the following assets were exempt:

- Infrared Cameras;
- Electroforce Test Bench;
- LCD Monitor;
- Wintest Software;
- Biological Safety Cabinet;
- Personal Computer Upgrade;
- Cisco Teleconference System; and
- Catalyst Analyzer System.

The Department agreed to refund sales tax "paid in error on [capital] assets." However, the Department found that three capital assets were not exempt from tax. Those three items included:

- Catalyst 48 Port Full Base;
- Storage Expansion Module; and
- Storage Blade.

The Department assessed sales tax on the purchase of these three items.

### **C. Taxpayer's Response to the Refund and Assessment Decisions.**

Taxpayer argues that the Department erred when it determined that certain purchases - or categories of purchases - were subject to Indiana sales tax. Taxpayer cites to thirty-one instances in which the Department erred. For reference sake, the thirty-one items include the dates on which the transactions were conducted.

At the outset, it should be noted that a "blade storage server" is a "stripped down server computer . . . optimized to minimize the use of physical space and energy." Blade Server, [https://en.wikipedia.org/wiki/Blade\\_server](https://en.wikipedia.org/wiki/Blade_server) (Last visited February 6, 2018).

- eClinical Software Licenses (2011); Taxpayer states that the eClinical software is an "electronic data capture" system which allows Taxpayer to "capture and manipulate lab based and live based data." Taxpayer explains that its remote study physician partners "enter patient's data into the eClinical software which is stored on servers at [Taxpayer's location]." The software acts as a "communication web based portal for the individual study sites to enter their data" and which allows Taxpayer to "manage, store, and process the study/patient date."
- Saturated Calomel Reference Electrode (2013); Taxpayer explains this is a "reference electrode" which used as a "benchmark" for testing reactions between different forms of mercury.
- Model 115 Volt Lab Heater (2012); According to Taxpayer, this is a "heat-o-matic" immersion heater used to heat liquids during lab testing.
- YSC Powerscope M400 (2012); Taxpayer states that this is a laboratory "powerscope" connected to a video monitor which allows "scientists to see samples magnified on a computer monitor."
- Open Test Corporation Collections Server (2014); Taxpayer explains that this is a computer server designed "specifically to hold intellectual capital, such as lab testing findings and results." Taxpayer further states that this server is "used to store lab results and data, data calculations, and findings . . . ."
- VWR International Pippets and Cryo Box (2013); According to Taxpayer, "pippets" are lab equipment used to hold liquids during test and "cryo boxes" are used to "hold test tubes in temperatures as low as -186 degrees Celsius." Taxpayer notes that the items "are often used for more than [one] year before they are discarded or become broken . . . ."
- Cybernetics AM-RFT C-24 Annual Maintenance Agreement (2012); Taxpayer states this is an exempt maintenance agreement for a miSAN computer server.
- Cybernetics RD-SATA-2T 2 TB SATA-II 7.2k (2012); Taxpayer explains that this is a computer hard drive used in "one of the [Taxpayer's] computers" and should be given the same 90 percent exemption provided to all of its other computers.
- Cybernetics AM-E48 Annual Express Depot SVE (2011); Taxpayer states that this is an exempt computer service agreement.
- Cybernetics AM-RFT Annual Maintenance Agreement (2012); According to Taxpayer, this is an annual maintenance agreement on a miSAN computer server.
- Cybernetics AM-RFT Maintenance Agreement (2012); Taxpayer states that this is the maintenance agreement for (another) miSAN computer server.
- Cybernetics AM-RFT Maintenance Agreement (2012); Taxpayer explains that this is the maintenance

agreement for (another) miSAN computer server.

- Cybernetics AM-RFT Maintenance Agreement (2012); According to Taxpayer, this is the maintenance agreement for (yet another) miSAN computer server.
- [Foreign Health Group] (2014); Taxpayer states that this was a payment to a foreign health group "to perform [a] . . . study in its medical facility" and constituted payment for an "exempt service performed outside America." This payment permitted the foreign health group "to have [a] live transmission of the case to engineering and clinical teams in the [United States]."
- OmniComm Annual Maintenance Agreement (2013); Taxpayer explains that this payment for an "unlimited number of [software] licenses" including "eClinical Suite . . . eClinical Portal, Data Capture, and Data Management." Taxpayer states that all of this software is "devoted to R&D and [is] exempt from sales tax."
- Xio Tech ISE Storage Blades Manager License (2012); According to Taxpayer, this payment was for a "Manager's license," and for server "warranties and maintenance" along with "Ethernet cable" and "fiber optic."
- Xio Tech ISE-2 Storage Blade Servers (2014).
- Dell Marketing Mojo Systems Catalyst 3750X (2013); Taxpayer states this is payment for "Cisco switches used to connect computer networks together."
- Cadre Information Security (2011); Taxpayer explains this is "computer software used to provide security to all of [Taxpayer's] computer and software systems . . . ." According to Taxpayer, because all its computer and software systems are used for lab testing, the security software is also exempt.
- CDW Direct McAfee Anti-Virus Software (2011); According to Taxpayer, the anti-virus software provides security to all of its computer systems - including lab testing and lab data - and "should be 90[percent] exempt because 90[percent] of the servers and computers it protects is devoted to R&D."
- Cisco Systems Capital Corp. Switches (2011); Taxpayer states that these switches are used to support Taxpayer's network and data software infrastructure.
- Cisco Systems Capital Corp. Maintenance Agreement (2011); Taxpayer explains that this is a maintenance agreement for its "internal infrastructure network."
- Cole Parmer (2011); According to Taxpayer, purchases from this vendor of laboratory "glass vials and stir rods" are exempt because they have a "useful life of over one year and are to devoted to R&D."
- Dell Marketing (2011); Taxpayer states that its purchase of "blade storage servers and related accessories" is exempt.
- Dell Marketing (2011); Taxpayer explains that its purchases of "external hard drives for data storage" are exempt.
- Dell Marketing (2011); According to Taxpayer, its purchases of "blade storage servers" is exempt from sales tax.
- Dell Marketing (2011); Taxpayer states that its purchases of "memory" for its blade storage server is exempt from sales tax.
- Dell Marketing (2011); Taxpayer explains that its purchase of blade storage servers and "related accessories" is exempt from sales tax.
- Dell Marketing (2011); Taxpayer maintains that its purchase of a hard drive "powerededge chassis" is exempt from sales tax.
- Dell Marketing (2011); Taxpayer states that is purchase of a "computer equipment service agreement" is exempt from sales tax.

- Fisher Scientific (2011); Taxpayer explains that it purchased "glass vials, pipets, beakers, and test tubes" all of which are glassware and all of which have a useful life of more than one year.
- Wintex P2P Fiber Optic Cable (2011); Taxpayer argues that its purchase of fiber optic cable is 90 percent exempt because the cable allows for "increased response time dealing with data calculations and data retrieval during its testing processes."

#### **D. Research and Development Exemption Statute and the Burden of Proof.**

IC § 6-2.5-5-40 (effective January 1, 2016) provides a sales tax exemption for research and development property. The current 2016 version of IC § 6-2.5-5-40 provides that certain activities are not considered research and development activities and clarifies that certain activities are considered incidental to research and development activities. Sales Tax Information Bulletin 75 (April 2017), 20170726 Ind. Reg. 045170335NRA.

To the extent that the Department assessed Taxpayer additional sales/use tax, and as a threshold issue, it is the Taxpayer's responsibility to establish that the tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). Further, "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, interpretations of Indiana tax law contained within this decision, as well as the preceding audit reference, are entitled to deference.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). Use means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is functionally equivalent to the sales tax. See *Rhoads v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

In the course of Taxpayer's business, Taxpayer [*sic*, Taxpayer] acquires items of "tangible personal property" such as computers, equipment, and computer software. The general rule is that when the ownership of tangible personal property is "transferred for [] consideration," that amount of consideration is subject to tax. [45 IAC 2.2-4-1](#).

However, Indiana law, IC § 6-2.5-5-40 (effective January 1, 2016) explains that a taxpayer is entitled to purchase certain items of tangible personal property without paying the gross retail tax when the property is used in the direct production of tangible personal property.

(a) As used in this section, "research and development activities" includes design, refinement, and testing of prototypes of new or improved commercial products before sales have begun for the purpose of determining facts, theories, or principles, or for the purpose of increasing scientific knowledge that may lead to new or enhanced products. The term does not include any of the following:

- (1) Efficiency surveys.
- (2) Management studies.
- (3) Consumer surveys.
- (4) Economic surveys.
- (5) Advertising or promotions.
- (6) Research in connection with nontechnical activities, including literary, historical, social sciences, economics, humanities, psychology, or similar projects.

- (7) Testing for purposes of quality control.
- (8) Market and sales research.
- (9) Product market testing, including product testing by product consumers or through consumer surveys for evaluation of consumer product performance or consumer product usability.
- (10) The acquisition, investigation, or evaluation of another's patent, model, process, or product for the purpose of investigating or evaluating the value of a potential investment.
- (11) The providing of sales services or any other service, whether technical or nontechnical in nature.
- (b) As used in this section, "research and development equipment" means tangible personal property that:
  - (1) consists of or is a combination of:
    - (A) laboratory equipment;
    - (B) computers;
    - (C) computer software;
    - (D) telecommunications equipment; or
    - (E) testing equipment;
  - (2) has not previously been used in Indiana for any purpose; and
  - (3) is acquired by the purchaser for the purpose of research and development activities devoted directly to experimental or laboratory research and development for:
    - (A) new products;
    - (B) new uses of existing products; or
    - (C) improving or testing existing products.
- (c) As used in this section, "research and development property" means tangible personal property that:
  - (1) has not previously been used in Indiana for any purpose; and
  - (2) is acquired by the purchaser for the purpose of research and development activities devoted to experimental or laboratory research and development for:
    - (A) new products;
    - (B) new uses of existing products; or
    - (C) improving or testing existing products.
- (d) For purposes of subsection (c)(2), a research and development activity is devoted to experimental or laboratory research and development if the activity is considered essential and integral to experimental or laboratory research and development. The term does not include activities incidental to experimental or laboratory research and development.
- (e) For purposes of subsection (c)(2), an activity is not considered to be devoted to experimental or laboratory research and development if the activity involves:
  - (1) heating, cooling, or illumination of office buildings;
  - (2) capital improvements to real property;
  - (3) janitorial services;
  - (4) personnel services or accommodations;
  - (5) inventory control functions;
  - (6) management or supervisory functions;
  - (7) marketing;
  - (8) training;
  - (9) accounting or similar administrative functions; or
  - (10) any other function that is incidental to experimental or laboratory research and development.
- (f) A retail transaction:
  - (1) involving research and development equipment; and
  - (2) occurring after June 30, 2007, and before July 1, 2013;is exempt from the state gross retail tax.
- (g) A retail transaction:
  - (1) involving research and development property; and
  - (2) occurring after June 30, 2013;is exempt from the state gross retail tax.
- (h) The exemption provided by subsection (g) applies regardless of whether the person that acquires the research and development property is a manufacturer or seller of the new or existing products specified in subsection (c)(2).
- (i) For purposes of this section, a retail transaction shall be considered as having occurred after June 30, 2013, to the extent that delivery of the property constituting selling at retail is made after that date to the purchaser or to the place of delivery designated by the purchaser. However, a transaction shall be considered as having occurred before July 1, 2013, to the extent that the agreement of the parties to the transaction is entered into before July 1, 2013, and payment for the property furnished in the transaction is made before July 1, 2013, notwithstanding the delivery of the property after June 30, 2013. This subsection expires January 1, 2017.

A previous version of IC § 6-2.5-5-40 (effective to June 30, 2013) referred to exempt "*equipment*" which the Department determined "does not include . . . property with a useful life of less than one year." Sales Tax Information Bulletin 75 (October 2008), 20081029 Ind. Reg. 045080815NRA. The "more than one year" requirement was deleted in IC § 6-2.5-5-40 (effective July 1, 2013 to December 31, 2015). As explained in Sales Tax Information Bulletin 75 (July 1, 2013), 20131127 Ind. Reg. 045130524NRA;

With regard to the new exemption available for research and development property purchased after June 30, 2013, there is no requirement that the property have a useful life of one year or more, nor are consumables or hand-powered tools excluded from the definition. (Emphasis added).

IC § 6-2.5-5-40(d) was added in 2015 to exclude items which are "incidental" to otherwise qualified research and development projects. In part, the statutory clarification states:

[Research and Development] does not include activities incidental to experimental or laboratory research and development [and] . . . any other function that is incidental to experimental or laboratory research and development.

IC § 6-2.5-5-40 like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Indiana law has long held that "[W]here [] an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974). 1 (citing *Conklin v. Town of Cambridge City*, 58 Ind. 130, 133 (1877)).

Nevertheless, the Department is also well aware of the countervailing rule that a "statute must not be construed so narrowly that it does not give effect to legislative intent because the intent of the legislature embodied in a statute constitutes the law." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991).

## **E. Analysis and Conclusions.**

The Department agrees with Taxpayer in part and disagrees in part. The Department agrees that the following transactions are not subject to sales or use tax:

The information establishes that the "Saturated Calomel Reference Electrode," "Model 115 Volt Lab Heater," and YSC Powerscope M400," qualify for the exemption because the devices are laboratory equipment under IC § 6-2.5-5-40(b).

The Department agrees that the "VWR International Pippets and Cryo Box (2013)" are exempt because the devices are laboratory equipment and because the exemption in effect at the time the items were purchased did not require that items such as these have a "useful life of more than one year."

The Department agrees that the price paid to "[Foreign Health Group] (2014)" is not subject to sales or use tax because the transaction was compensation for an exempt service and not tangible personal property.

The Department agrees that the following purchases qualify for the 90 percent exemption determined at the Department's initial audit review because it was agreed that Taxpayer's computers "used 90[percent] of [the] time for research . . ." and were "taxable 10 percent of the time."

- Cybernetics RD-SATA-2T 2 TB SATA-II 7.2k (2012);
- Xio Tech ISE-2 Storage Blade Servers (2014).
- Dell Marketing Mojo Systems Catalyst 3750X (2013);
- Cisco Systems Capital Corp. Switches (2011);
- Dell Marketing (2011); "blade storage servers and related accessories;"
- Dell Marketing (2011); "external hard drives for data storage;"



- Dell Marketing (2011); "blade storage servers;"
- Dell Marketing (2011); "blade storage servers;"
- Dell Marketing (2011); "memory" for its blade storage server;
- Dell Marketing (2011) blade storage servers and "related accessories";
- Dell Marketing (2011); a hard drive "power edge chassis"; and
- Wintex P2P Fiber Optic Cable (2011).

The Department does not agree that the following computer or software items are exempt because they do not directly affect Taxpayer's research and development processes; they are "peripheral" or incidental to Taxpayer's research process.

- eClinical Software Licenses (2011);
- Open Test Corporation Collections Server (2014);
- Cybernetics AM-RFT C-24 Annual Maintenance Agreement (2012);
- Cybernetics AM-E48 Annual Express Depot SVE (2011);
- Cybernetics AM-RFT Annual Maintenance Agreement (2012);
- Cybernetics AM-RFT Maintenance Agreement (2012);
- Cybernetics AM-RFT Maintenance Agreement (2012);
- Cybernetics AM-RFT Maintenance Agreement (2012);
- OmniComm Annual Maintenance Agreement (2013);
- Xio Tech ISE Storage Blades Manager License (2012);
- Cadre Information Security (2011);
- CDW Direct McAfee Anti-Virus Software (2011); and
- Cisco Systems Capital Corp. Maintenance Agreement (2011).

The Department does not agree that the following purchases of laboratory equipment are exempt because, under the exemption statute then in effect, equipment with a useful life of less than one year was not exempt. In this case, Taxpayer has not established that these essentially disposable items "constituted "equipment" and not "expendables."

- Cole Parmer (2011); laboratory "glass vials and stir rods";
- Fisher Scientific (2011); "glass vials, pipets, beakers, and test tubes."

### **FINDING**

Taxpayer's protest is denied in part and sustained in part as detailed in Part I.E above.

## **II. Administration - Ten Percent Negligence Penalty.**

### **DISCUSSION**

Taxpayer argues that its failure to pay the full amount of sales tax on its purchases was a "result of reasonable

cause and not willful neglect, negligence or carelessness." According to Taxpayer, it had a reasonable belief that many of the purchases were exempt from tax because it is a company "solely dedicated and devoted to conducting medical and medical device research and development . . . ."

IC § 6-8.1-10-2.1(a)(3) requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. IC § 6-8.1-10-2.1(a)(2) requires a ten-percent penalty if the taxpayer "fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment."

IC § 6-8.1-10-2.1(d) states that, "If a person subject to the penalty imposed under this section can show that the failure to . . . pay the full amount of tax shown on the person's return . . . or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty."

Departmental regulation [45 IAC 15-11-2](#)(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case by case basis according to the facts and circumstances of each taxpayer." *Id.*

Departmental regulation [45 IAC 15-11-2](#)(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Under IC § 6-8.1-5-1(c), "The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." An assessment - including the negligence penalty - is presumptively valid.

The Department believes that Taxpayer erred in determining its sales and use tax liability. However, there is insufficient information to establish that Taxpayer's interpretation and application of the research and development exemption was so egregious as to constitute "willful neglect." Based on a "case by case" analysis and after reviewing "the facts and circumstances of each taxpayer" the Department agrees that the ten-percent negligence penalty should be abated.

## **FINDING**

Taxpayer's protest is sustained.

## **CONCLUSION**

Taxpayers protest with respect to the exempt nature of various pieces of equipment used in research and development is sustained in part and denied in part detailed in Part I.E. Taxpayer's protest with respect to abatement of the negligence penalty is sustained.

March 19, 2018

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